

APPENDIX XII-7
THE ADMINISTRATOR OF NATIONAL BANKS
WASHINGTON, D.C. 20220

April 16, 1970

Mr. Woodward Kingman, President
Government National Mortgage Association
Department of Housing and Urban Development
451 Seventh Street, S.W.
Washington, D.C. 20414

Dear Mr. Kingman:

This is in reference to the meeting held on April 8, 1970, attended by members of our respective staff, for the purpose of discussing the extent to which national banks, under applicable law and regulations, may participate in the mortgage-backed securities program made possible by Section 306(g) of the National Housing Act. This program involves the issuance of securities by private issues which will be guaranteed by the Government National Mortgage Association (GNMA) and will also be backed by pools of mortgages insured under the National Housing Act, Title V of the Housing Act of 1949, the Servicemen's Readjustment Act of 1944 or Chapter 37 of Title 38, United States Code.

Three types of securities (hereinafter collectively referred to as MBS) are contemplated under GNMA's pass-through program. Under the first, called the "straight pass-through" type, provision is made for the payment to the holders of a proportionate share of the proceeds of the principal and interest, as collected, on account of the pool of mortgages involved, less servicing fees and other specified costs approved by GNMA.

The second type, called the "partially modified pass-through," provides for the payment to the security holders of a proportionate share of the proceeds of the principal as collected together with a fixed rate of interest on the unpaid principal balance, whether or not collected.

The third, called the "fully modified pass-through," provides for such payment, whether or not collected, of both specified principal installments and a fixed-rate of interest on the unpaid principal balances. Prepayments on the pooled mortgages are passed-through to the holders of the securities, in all three types.

Full details and specimen forms for the program are contained in the GNMA Mortgage-Backed Securities Guide dated December 1969, GNMA Document No. 5500.1.

Our views have been requested as to the legality and appropriateness of participation by national banks in the above program in four possible capacities: (1) as issuers of MBS; (2) as custodians of the pools of mortgages; (3) as purchasers of MBS for their own account; and (4) as purchasers of MBS in fiduciary capacities. The following conclusions apply to all three types of pass-through securities described above:

1. As issuers of MBS. National banks may legally incur debt up to the limit specified in 12 U.S.C. 82, excluding certain ordinary course of business obligations which are listed in the statute. Therefore, the question arises whether the amount of MBS issued by a national bank must be included in the bank's total outstanding indebtedness for the purposes of 12 U.S.C. 82. Under the program as outlined in the GNMA Securities Guide, it appears that the legal function of the MBS issuer will be more like that of a mortgage servicing corporation than that of a borrower. The basic functions of the issuer will be: (1) to deliver a pool of underlying FHA and VA mortgages in good form to the custodian and (2) to see to it that payments of principal and interest on the underlying mortgages are timely collected and paid over to the holders of the MBS it issues. Since the MBS issuer will turn over to the custodian the underlying pool of mortgages, constituting the collateral for the outstanding MBS, there will be no loan assets remaining in the issuing bank at the credit risk of the issuing bank. Furthermore, the MBS holder may look only to the pool and to the GNMA guarantee, not to the issuer. We conclude therefore that there is no reason to include the outstanding amount of MBS issued by a national bank as a liability for the purposes of the limitations contained in 12 U.S.C. 82, provided that the underlying pool of mortgages are not carried as assets on the books of the issuing bank.

2. As custodian of a collateral pool. National banks customarily act as escrow agents, safe-keeping custodians and in similar capacities. There is no statute or regulation which would interfere with a national bank acting as a custodian of one or more mortgage pools under the program.

3. As purchasers of MBS for its own account. MBS issued by other issuers under the program will be eligible for purchase for investment by any national bank without limitation as to amount, since the securities will be guaranteed by GNMA and are therefore excepted from the limitations contained in Paragraph Seventh of 12 U.S.C. 24.

4. As purchasers of MBS in fiduciary capacities. Where appropriate under the governing trust instrument, a national bank, as fiduciary, may purchase MBS issued by other issuers.

Inasmuch as the securities will be guaranteed by an instrumentality of the Government of the United States, these securities will be exempt under Section 3(a) (12) from the registration requirements of the Securities Exchange Act of 1934 and from Part 16 of the regulations of the Comptroller of the Currency (12 CFR 16).

If you have further questions in regard to participation by national banks in the GNMA mortgage-backed securities program, please do not hesitate to communicate them to this Office.